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Perspective

European Political and Economic Considerations in the Yamburg Pipeline [redacted]

Construction of the Yamburg gas pipeline from the USSR has powerful political support in Western Europe, but there is growing uncertainty as to whether there will be a market for all the Soviet gas the pipeline could carry. In Western Europe there are strong political constituencies favoring, and littl political opposition to, construction of the pipeline:

- Many West European and Japanese firms are anxious to sell the vast amounts of pipe, compressors, and other equipment needed for the project.
- The Europeans and Japanese regard the prospective Soviet hard currency earnings from the pipeline as necessary to sustain, if not to expand, the Soviet market for their exports in the longer term.
- Both European governments and private interests favor diversification of sources of energy supply and consider Soviet gas to be more reliable than some other energy sources.
- The dominant European view is that closer ties with the Soviet Union on ba ance reduce the chances of aggressive Soviet behavior.
- And many believe, or want to believe, that a contented Russian bear is generally less dangerous than a hungry one.

This does not mean, however, that all will be smooth for the pipeline projec The project has already been reduced from a dual line to a single line carry 2.9 billion cubic feet per day of gas (about 500,000 b/d oil equivalent) to Western Europe, or some 60 percent of the capacity of a dual line. Agreeme in principle has been reached with most key European countries on financi terms, but the quantities of Soviet gas each country will need and the price be charged are still uncertain and may be the subject of lengthy negotiatio Although it would be difficult for the Europeans to back out of the single pi line, the odds are turning strongly against construction of the second line a any time in the foreseeable future.

It is no longer certain that demand for gas in Western Europe will be suffic to justify building the pipeline. The pipeline project was conceived during a riod of extreme tightness in energy markets and rapidly rising oil prices. Almost any new source of energy was viewed favorably as a means of reduc market pressure and dependence on Persian Gulf supplies. But during the year or so, the oil shortage has turned to glut and perceptions of energy prospects have been changing rapidly. The growing evidence of a large-sc

conservation response to higher energy prices has led to much lower projections of energy demand. The gas market also has weakened. In 1980 for the first time in decades, consumption of natural gas in Europe declined (by 4 percent)—an occurrence which must have been a great shock to utility companies. The decline in gas consumption appears to be continuing in 1981. These recent trends were not factored into the latest official European gas projections, which were produced for the IEA in 1980. [redacted]

Even using the official projections, by 1990 the European market may not be able to absorb all the Soviet gas even a single pipeline could carry. In both West Germany and Italy domestic production and existing agreements to import from the Netherlands, Algeria, Norway, Nigeria, and the USSR about cover projected gas consumption in 1990. In France and Belgium, substantial additional agreements are needed to cover projected gas consumption, but most of the additional requirements could be met from sources other than the USSR, if these countries were willing to substantially increase their dependence on African producers. For Western Europe as a whole, [redacted] could not accommodate any gas from the new Soviet pipeline.

Future trends in gas consumption will of course be strongly affected by movements in the price of gas relative to other energy sources. Some forecasts apparently assume that gas prices will rise faster than crude oil prices, a trend that would dampen the demand for gas. At prices above residual fuel, natural gas will probably not be used in low value applications in industry and electricity generation. And because of long leadtimes in delivering new gas projects and high capital investment costs of developing infrastructure, the European utilities must price gas now to guarantee a market in the late 1980s. Should Moscow be willing to lower its prices to, for example, the equivalent of residual fuel oil, it could probably assure a market for its gas. Unless West European governments put strong pressure on the utility companies to come to terms with Moscow on Soviet gas, many months may pass before agreement is reached.

Should Moscow agree to sell gas from the pipeline at a price equivalent to residual fuel oil (about $4 per thousand cubic feet), its hard currency earnings from this source would be only $4.2 billion, or about 40 percent of the earnings projected for the dual pipeline at a crude oil parity price (about $6 per thousand cubic feet). These earnings would offset only about one-third of the hard currency earnings from current Soviet oil exports.

[redacted]